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SIPDIS

SENSITIVE

STATE FOR EAP/EP, EB/TPP
STATE PASS USTR FOR BWEISEL AND DKATZ
STATE PASS USAID AND OPIC
TREASURY FOR OASIA FOR AJEWELL
USDOC FOR 4430/ITA/MAC/DBISBEE

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TAGS: [ECON](#) [ETRD](#) [PREL](#) [KIPR](#) [TBIO](#) [TSPL](#) [RP](#) [APEC](#) [WTRO](#)
SUBJECT: PHILIPPINES: SLOW PACE OF ECONOMIC REFORM

REFS: A) MANILA 4278, B) MANILA 4112

SENSITIVE BUT UNCLASSIFIED: NOT FOR INTERNET DISTRIBUTION

1. (SBU) Summary: Philippine government and private sector leaders told U.S. Senior Official for APEC Michael Michalak that the Philippines continues to face problems with inefficient courts and corruption in general. Poor implementation and unpredictable enforcement of laws remain disincentives to investment. They offered a more optimistic assessment of the country's fiscal situation, although many raised concerns about the implementation of the new expanded Value Added Tax (EVAT). The Millennium Challenge Account (MCA), many said, is an encouraging development that could lead to much needed structural change. End Summary.

Informing about APEC

2. (SBU) During his September 19-20 visit to Manila, U.S. Senior Official for APEC Michael Michalak briefed GRP leaders on U.S. priorities in APEC. He told them that the U.S. will pursue three key objectives at the high-level APEC meetings in November: 1) advancing the Doha Development Agenda in preparation for the December WTO Ministerial in Hong Kong; 2) addressing energy security in the region, especially related to high oil prices and the impact on the regional economy; and 3) formulating a strong response to the potential Avian Influenza pandemic. He also sought their views on the U.S.-RP economic relationship and encouraged them to use the funds available under the MCA to implement needed structural reforms.

Good laws, lousy implementation

3. (SBU) Former Trade Secretary Senator Manuel "Mar" Roxas, who chairs the Trade and Commerce and the Economic Affairs committees in the Senate, told Michalak that implementing legislation and fighting corruption are the GRP's biggest challenges. The GRP must take structural approaches to combating smuggling and improve the country's trade outlook, according to Roxas. However, the level of corruption in the Bureau of Customs (BOC) makes reform progress difficult, he said. Roxas was eager to explore possibilities of linking APEC security measures to initiatives detecting smuggling. Because corruption is so much a part of the BOC culture, he said, the GRP must, in effect, create an external mechanism to police the BOC. Michalak urged Roxas to partner with the business community on such initiatives and to solicit its input on which structural reforms are most needed. Roxas was optimistic that some of the GRP's MCA programs could be used to address these issues.

4. (SBU) Roxas said there is a perception in the RP that trade liberalization has failed to deliver promised benefits, but acknowledged this is due largely to the oligarchic power structure and GRP's failure to implement necessary structural reforms. The GPR should have done more to solidify reform and ensure competition in the domestic market at the same time it was lowering tariffs, he admitted. Roxas told Michalak that he now espouses a more cautious approach to liberalization because of these structural shortcomings. Citing the GRP's lack of expertise in trade negotiations, he said he is submitting legislation to create a "Special Trade Representative" similar to USTR. The position may be an office in the Department of Trade and Industry or a separate official under the Office of the President, he said, but would focus exclusively on the RP's international trade agenda.

EVAT will be implemented

15. (SBU) Senator Ralph Recto, chairman of the Senate Ways and Means Committee, told Michalak he is optimistic that the EVAT will be implemented in full within the next two to three weeks (ref B). The conditions have already been met, said Recto, for President Arroyo to automatically trigger the VAT rate increase to 12% from 10% in January 2006. Recto estimated the EVAT will generate 80-100 billion pesos (1.4-1.8 billion dollars) in additional revenues in 2006 and will enable the GRP to address many of its current fiscal difficulties.

16. (SBU) Recto discounted attempts to pass a joint resolution delaying the imposition of VAT on fuel and electricity until June 2006. He said the House will be too preoccupied with passing the budget and debating Constitutional changes to push the issue much further. He finds it frustrating, he told Michalak, that President Arroyo is now sending mixed signals on whether Congress should delay EVAT implementation, especially after she pressed lawmakers to pass a tax increase they did not favor. Recto said he has always favored expanding the tax base over increasing rates and fears that a delay in lifting exemptions on fuel and electricity could erode the effectiveness of the new measure.

Cha-Cha could open markets

17. (SBU) Recto told Michalak that redrafting the Constitution could offer opportunities on trade and investment liberalization. Michalak encouraged Recto to support liberalization and said this may be an opportunity to update provisions related to the business climate in a very positive way. Recto agreed. He linked the emigration of many talented Filipinos to investment climate problems that he said are related to constitutional limits on foreign ownership of land and certain businesses and the entry of non-Filipinos into certain professions. Charter change does not currently have enough support to receive the necessary two-thirds of votes in the Senate, he said, but he and others may be open to the change if restrictions on foreign investment are lifted. This is the only way, according to Recto, to increase foreign investment in the Philippines, which is lagging far behind neighboring countries.

GRP needs more revenue

18. (SBU) House Committee on Trade and Investment Chairman Congressman Junie Cua told Michalak that, amidst the difficulties the RP now faces, even small statements of U.S. support help. The Philippines continues to be interested in a free trade agreement with the U.S., he said, but would be very cautious in negotiating on agriculture issues. Michalak replied that the U.S. will likely continue to work through the current Trade and Investment Framework Agreement (TIFA) instead of immediately engaging on FTA discussions, but emphasized that the Millennium Challenge Account is a sign of how serious the U.S. is about assisting the Philippines.

19. (SBU) The GRP budget deficit continues to be of concern, Cua said, and the government needs to generate more revenue. However, the imposition of the EVAT will be "hard" and it might be "politically desirable" to delay the VAT on electricity and gasoline to let recent political turbulence cool off. He said it looks like tax and customs collection figures are improving, but he admitted there is still much to do on this front. On IPR, he said that members of Congress want to ensure that the legislation they provide (such as the Optical Media Act) is enforced. Oversight, he said, will be more vigorous because "if we just pass legislation and there is no follow-through it won't be worth it."

Need more anti-corruption justices

10. (SBU) Ombudsman Simeon Marcello told Michalak his greatest obstacle to prosecuting corruption cases is the low number of cases the Philippine corruption court ("Sandiganbayan") is able to handle. The key to change is increasing the number of justices and allowing single justices to hear cases instead of using the current panel system, he said. Acknowledging the need to improve anti-corruption efforts, Marcello asked, "How can I fight a war without soldiers?" The budget now before Congress increases his office's funding by enough to add an additional 48 prosecutors and 200 investigators to his staff, but according to Marcello, that is still not

enough. He estimated he needs another 100 prosecutors to effectively pursue all of the cases the Ombudsman's office should be prosecuting. Even with the increased budget, he said it will be difficult to find enough qualified individuals to fill the new positions because authorized salaries are low. He also said that if he files more than the current number of cases each month, the court would not have the capacity to hear all of the cases. He was hopeful that some of the MCA money the Philippines may receive will be used to address these inadequacies.

Business leaders pessimistic

11. (SBU) Michalak also met with American and Filipino Business leaders during his visit. They welcomed the news that APEC is pursuing action on Avian Flu, underscoring that a widespread outbreak could be devastating for the region (ref A). There was limited awareness of APEC's activities among leaders not already engaged on APEC, but APEC Business Advisory Council (ABAC) members are influential in Philippine circles. Former Foreign Affairs Secretary and ABAC member Roberto Romulo told Michalak he thinks trade facilitation should be the top priority for APEC. He noted that the growing number of FTAs in the region sometimes disrupts trade more than stimulates it. Templates for WTO-plus agreements from APEC could prove useful in ensuring that these trade pacts harmonize. Michalak told ABAC members that the U.S. hopes to see ABAC more active in APEC deliberations.

12. (SBU) Concerning the economic situation in the Philippines, the business leaders were uniformly critical of the Philippine courts and the BOC. Potential investors need more predictability from both regulatory agencies and the courts in interpreting laws, they said. While agreeing that East Asia will be a growth driver for firms, both American and Filipino business executives expressed concern that the Philippines is becoming marginalized. Business leaders said the Philippines does not stack up against other investment destinations because of the unpredictable implementation of laws and regulations as well as rising labor costs.

Johnson